August 2, 2005

**Minutes Of The Meeting Of The
Treasury Borrowing Advisory Committee
Of The Bond Market Association
August 2, 2005**

The Committee convened in closed session at the Hay-Adams Hotel at 11:30 a.m. One member of the Committee, Ina Drew, was not present. Assistant Secretary for Financial Markets Timothy Bitsberger welcomed the Committee and gave them the charge.

Assistant Secretary Bitsberger highlighted a few of the quarterly refunding charts released on August 1, noting that Treasury's borrowing this fiscal year is less than was projected earlier in the year and that this is largely due to increased tax receipts and higher-than-expected SLGS issuance. He noted the sizeable net pay down in bills last quarter. He also noted the volatility in Treasury's borrowing needs in the next couple of fiscal years, with estimated borrowing needs rising in FY2006.

The Committee then addressed the first question in the Committee charge (attached) on issues that Treasury should consider when making its decision on whether or not to re-introduce the 30-year bond. Assistant Secretary Bitsberger presented a series of charts highlighting the impact of 30-year issuance on Treasury's financing needs, the flexibility of its portfolio and cost. He emphasized that the 30-year bond is not necessary to meet expected financing needs, and that modest issuance does not adversely impact Treasury's debt portfolio flexibility. Assistant Secretary Bitsberger also noted that re-introduction of the 30-year bond diversifies funding and increases the investor base. The charts show that re-introduction of the bond would halt the decline in average maturity of debt outstanding and modestly lower Treasury's rollover need.

The Committee was asked if there are other issues Treasury should consider. Several Committee members raised calendar and auction-schedule issues. One Committee member suggested that if Treasury plans to issue the first 30-year bond in February 2006 on a February/August cycle, that Treasury should have the August issue be a reopening of the February issue. The Committee member also suggested that, if this is Treasury's intention, Treasury should make this explicit when they announce the re-introduction. Another Committee member brought up the issue of stripping and making the new 30-year issues fungible with currently outstanding 30-year bonds. Another Committee member asked about the timing of a bond auction in the refunding, noting that it would mean four coupon auctions in one week. Assistant Secretary Bitsberger said that Treasury is open to ideas on what to do with the issuance calendar and that Treasury would come back to the market in the next quarter to solicit comments on this issue.

One Committee member asked what would happen to Treasury's debt portfolio flexibility if bonds are added and deficits come in lower than expected several years from now. Treasury officials pointed to the table highlighting that with modest bond issuance, Treasury will still have the flexibility to meet changes in financing needs.

Next the Committee turned to the second question on the need for a backstop securities lending facility. The Treasury asked for the Committee's preliminary views on whether this idea provides sufficient benefits to the Treasury and the market to warrant further study. Assistant Secretary Bitsberger presented slides on the factors that led Treasury to consider such a facility and the initial thoughts on a potential structure of a facility. The first slides highlighted the growth of trading volumes in Treasuries compared to supply, the increasing fails, and the potential risks of large scale fails. The following slides noted potential sources for additional supply, including the Federal Reserve Bank of New York's securities lending facility, large holders of securities, and the development of a backstop Treasury securities lending facility. The next set of slides highlighted Treasury's desired outcomes – including facilitating settlement of cash market transactions, improved functioning of the specials market, and strengthening of the specials market – while continuing to provide certainty of supply and encouraging market-driven solutions to supply-demand imbalances.

Assistant Secretary Bitsberger then described some of the desired attributes of a backstop securities lending facility and how such a facility might work. Desired attributes include a non-discretionary, standing facility with unlimited supply on renewable terms. The price would be set at a penalty rate to discourage use unless the market was severely stressed. The facility would not be designed to address temporary needs, so the term would be greater than overnight.

Assistant Secretary Bitsberger highlighted that there are lots of questions to be answered, including policy issues, regulatory issues, and operational issues, and that a project like this would take some time. He emphasized that Treasury really wants the Committee's ongoing advice on this issue in the future.

One Committee member commented that the supply-demand dynamic in Treasuries is changing, that Treasury should look at ideas to help maintain market liquidity, and that this idea is worth pursuing. Another Committee member said that a backstop securities lending facility is just one of a series of things that Treasury should look at in order to maintain liquidity in the Treasury marketplace. At least one Committee member commented that a securities lending facility was not a good idea. Two other Committee members commented that the recent episodes of increased fails were related to increased hedging and speculative activity in the Treasury market rather than any systemic issues. Another Committee member noted that the level of fed funds, and the fact that it has been steadily rising, may also be impacting activity in the repo market.

Several Committee members discussed the structure of the Treasury futures contract in the context of the recent issues surrounding the cheapest-to-deliver issue into the 10-year notes futures contract. One Committee member encouraged the Chicago Board of Trade (CBOT) to change the coupon on the futures contract, while another commented that there are other fixes that the CBOT could consider. One Committee member reminded the group that the futures contract was the purview of the CBOT, not Treasury.

One Committee member asked if Treasury had considered offering an exchange program, exchanging older off-the-run securities for new securities (ex. exchanging an old 10-year note with 5 years left to maturity for a current 5-year note). A Treasury official noted that Treasury sells certainty of supply and that the only way that supply would change is if there is a possible systemic problem. He noted that the current buy-in rule does not work in its current form, thereby allowing contracts not to be fulfilled.

One Committee member questioned whether it was the role of Treasury to enforce contracts, commenting that maybe it should be the market or the counterparties' role to enforce the contracts. Other Committee members commented that this was the role of the SEC or the NASD.

A Committee member commented that Treasury needs to better establish the link between increased levels of fails and increased cost of issuing a new security.

One Committee member asked at what level of fails is Treasury concerned about efficient market functioning. Another member noted that it is probably very difficult to say what this level is.

A Committee member asked about negative repo rates, commenting that if the rate on a facility is set below zero, that this will encourage market participants to continue to short the market, increasing the incentive for speculative activity. Another Committee member noted that this may also encourage participants to lend. Another Committee member commented that there is currently no established negative rate trading in the repo market. Another member noted that there is no standard guaranteed delivery in the repo market, and if there was, there would be trading at negative rates. One Committee member noted that a barrier to negative rate trading was the fact that many market participants' trading systems currently can not process negative rates.

One Committee member asked if this type of facility would be available only to broker/dealers or to a wider audience. Assistant Secretary Bitsberger said that this was one of the issues to be discussed, and that Treasury would come back to the Committee for further input on this type of question. Another Committee member commented that the calculation of the penalty rate on the facility would have to be considered very carefully.

Next, the Committee turned to the third question of the charge which asked for the Committee's views on foreign ownership of Treasury securities and whether sizable foreign ownership has contributed to lower domestic interest rates. One Committee member presented a series of slides showing that currency movements can impact Treasury's cost of borrowing through a lower exchange rate creating more stimulative financial conditions, and that foreign official investors exert downward pressure on

Treasury's cost of borrowing through the funding of the current account deficit. Other factors limiting the increase in yields include a decrease in risk premiums, an increase in the global savings rate, and structural changes in the bond market. However, the Committee member argued that the impact of some of the factors could wane. One of the slides showed the maturity structure of dollar-denominated assets held by foreigners, and the Committee member noted that foreigners have increased their holdings of longer duration debt.

Finally, the Committee discussed its borrowing recommendations for the August refunding and the remaining financing for this quarter as well as the October – December quarter. Charts containing the Committee's recommendations are attached. One Committee member asked about the date of the 3-year auction and a Treasury official said the date of the auction is Monday, August 8, due to the FOMC meeting on August 9.

The meeting adjourned at 1:15 p.m.

The Committee reconvened at the Hay-Adams Hotel at 6:00 p.m. Ina Drew and Richard Axilrod were not present. The Chairman presented the Committee report to Assistant Secretary Bitsberger. A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:30 p.m.

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Jeff Huther
Director
Office of Debt Management
August 2, 2005

Certified by:

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Ian Banwell, Chairman
Treasury Borrowing Advisory Committee
of The Bond Market Association
August 2, 2005

Attachments:
Link to the Treasury Borrowing Advisory Committee discussion charts
U.S. Treasury - Office of Domestic Finance

Treasury Borrowing Advisory Committee Quarterly Meeting
Committee Charge – August 2, 2005

Reintroduction of the 30-Year Bond

In the accompanying charts, we present the reasons for why Treasury is considering reintroducing 30-year bonds. Are there other issues that Treasury should consider regarding the decision to reintroduce the 30-year?

Treasury Securities Lending Facility

The growth of trading volumes in Treasury securities, relative to supply, has led us to consider the need for a *backstop securities lending facility* to mitigate the risk of systemic fails. A risk that we believe could impair liquidity and raise our cost of borrowing. In the accompanying slides we present the factors that prompted this consideration and our initial thoughts on a potential structure of a facility. We seek the Committee's preliminary views on whether this idea provides sufficient benefits to the Treasury and the markets to warrant further study.

The Impact of Foreign Ownership on Interest Rates

Please discuss the impact of currency movements on the Treasury's cost of borrowing. Are foreign investors exerting significant downward pressures on the Treasury's financing costs or are other forces at work which have limited increases in yields?

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes to refund approximately $18.6 billion of privately held notes and bonds maturing on August 15, 2005.
- The composition of Treasury marketable financing for the remainder of the July–September quarter, including cash management bills.
- The composition of Treasury marketable financing for the October-December quarter.